



DEPARTMENT OF  
**FINANCE**

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October 24, 2005

Ms. Lucy Dunn, Director  
Department of Housing and Community Development  
1800 Third Street  
Sacramento, CA 95814

Dear Ms. Dunn:

**Final Report—Quality Assurance Review**

Enclosed is our final quality assurance review report on the Department of Housing and Community Development's Audit Division (Division). The report provides an opinion on the Division's compliance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*, and suggestions for quality improvement. The final report includes the Division's response to the recommendations.

In accordance with Finance's policy of increased transparency, this report will be placed on the Finance website. We appreciate your staff's cooperation and assistance during our review. If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Richard Hebert, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Janet I. Rosman

Janet I. Rosman, Assistant Chief  
Office of State Audits and Evaluations

Enclosure

cc: Ms. Judy Nevis, Chief Deputy Director, Department of Housing and Community Development  
Mr. Keith Jung, Chief, Audit Division, Department of Housing and Community Development

# A QUALITY ASSURANCE REVIEW

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## Department of Housing and Community Development Audit Division

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

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The Department of Housing and Community Development's (Department) mission is to provide leadership, policies, and programs to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians.

The Department's goals are to:

- Advocate and support housing development for all Californians.
- Develop, administer, and enforce building codes, manufactured housing standards, and mobile home park regulations.
- Administer state and federal housing and community development finance programs.
- Compile and disseminate critical information on housing, planning, financing, and community and economic development issues.

The Department's Audit Division's (Division) primary function is to assist members of the Department in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations, and information concerning the activities reviewed, and by promoting effective control at a reasonable cost.

The Department of Finance, Office of State Audits and Evaluations, conducted this quality assurance review in accordance with the Government Code Section 13071, which requires the State's internal auditors to comply with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*. These standards require that the Department's Division receive an external quality assurance review at least once every five years.

This report is intended solely for the information and use of Department management and is not intended to be and should not be used by anyone other than this specified party. However, this report is a matter of public record and its distribution is not limited.

## **STAFF:**

Frances Parmelee, CPA  
Manager

Richard Hebert, JD  
Supervisor

Art Rogers, CPA

# INDEPENDENT REVIEWER'S REPORT

## INTRODUCTION

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### Review Objectives

Our primary objectives were to: (1) determine the Audit Division's (Division) compliance with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing (Standards)*, (2) appraise the quality of the Division's operations, and (3) provide recommendations for improving the Division's compliance with the *Standards*.

The *Standards* encompass the following:

- The Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing*

Attribute Standards:

- 1000—Purpose, Authority, and Responsibility
- 1100—Independence and Objectivity
- 1200—Proficiency and Due Professional Care
- 1300—Quality Assurance and Improvement Program

Performance Standards:

- 2000—Managing the Internal Audit Activity
- 2100—Nature of Work
- 2200—Engagement Planning
- 2300—Performing the Engagement
- 2400—Communicating Results
- 2500—Monitoring Progress
- 2600—Management's Acceptance of Risks

- The Institute of Internal Auditors' *Code of Ethics*

### Review Scope

In order to assess the Division's compliance with the *Standards*, we reviewed its activities for the period January 1, 2003 to June 30, 2005. We conducted our review in accordance with the Institute of Internal Auditors' *Quality Assurance Review Manual, Fourth Edition*. The scope of our review included:

- A self-study report, completed by the Division Chief, which provided background information concerning the Division's organizational status, operating environment, practices, policies, and procedures.
- Interviews with the Division Chief and Department Chief Deputy Director.
- An audit survey sent by the Division to selected audit customers, which solicited their responses concerning the scope, nature, and quality of internal auditing.

- A review of audit policies, procedures, practices, and information used for managing the Division.
- Reviews of selected audit reports and working papers.

We conducted our fieldwork during July 2005.

## Opinion

In forming an overall opinion on the Division's compliance with the *Standards*, we utilized the opinions delineated in the *Quality Assurance Review Manual, Fourth Edition*, as defined below.

**Generally Conforms**—Policies, procedures, and an internal auditing charter existed and were deemed to be in accordance with the *Standards*. Any deficiencies found in applying the policies, procedures, and charter provisions were deemed minor.

**Partially Conforms**—Policies, procedures, and an internal auditing charter existed, but they were not in complete compliance with the *Standards*, or significant deficiencies in practice were found that deviated from the *Standards*.

**Does Not Conform**—Existing policies, procedures, and an internal auditing charter, where present, were deemed not to comply with the *Standards*, and/or deficiencies in practice were so significant as to seriously impair audit quality.



## O PINION

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We completed an independent quality assurance review of the Department of Housing and Community Development's Audit Division (Division), based on an evaluation of the Division's practices and audits completed during the period January 1, 2003 to June 30, 2005. In our opinion, the Division *generally conforms* with the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing (Standards)*.

This opinion means that policies, procedures, and an internal auditing charter existed and were deemed to be in accordance with the *Standards*. Any deficiencies found in applying the policies, procedures and charter provisions were deemed minor. Our opinion is based on fieldwork conducted during July 2005.

Specific instances of minor deficiencies with the *Standards* are described in the *Conditions and Recommendations* section of this report. Our recommendations, if implemented, will assist the Division in improving audit quality and ensuring continued compliance with the *Standards*.

Original signed by Janet I. Rosman

Janet I. Rosman, CPA  
Assistant Chief, Office of State Audits and Evaluations  
(916) 322-2985

July 27, 2005

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## CONDITIONS AND RECOMMENDATIONS

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This section contains our observations on the Audit Division's (Division) compliance with the *Standards for the Professional Practice of Internal Auditing (Standards)*. For each category, we cite the *Standards* and discuss the Division's compliance. For those areas containing minor deficiencies, we recommend corrective action for fully implementing the applicable standard.

- A. 1000—Purpose, Authority, and Responsibility (Charter):** The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the *Standards*, and approved by the board of directors/audit committee.

A written audit charter is critical to managing the internal audit function because it defines the unit's purpose, authority, and responsibility. Specifically, the audit charter establishes the role of the internal audit activity within the Department and provides a basis for management's evaluation of the operations. The Division's audit charter, approved by the Department's Director in October 1994, defines the unit's purpose, authority, and responsibility, and is consistent with the *Standards*.

- B. 1100—Independence and Objectivity:** The internal audit activity should be independent, and internal auditors should be objective in performing their work.

The Division's independence is achieved through its reporting structure and organizational status. The Division reports administratively and functionally to the Department's Chief Deputy Director and Audit Committee, respectively. Additionally, the audit charter defines auditor objectivity.

- C. 1200—Proficiency and Due Professional Care:** Engagements should be performed with proficiency and due professional care.

Division management and staff collectively possess the knowledge and skills essential for the professional practice of internal auditing. Division management appropriately supervises the staff to assure conformance with the *Standards*.

- D. 1300—Quality Assurance and Improvement Program:** The CAE (Division Chief) should develop an ongoing quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness.

The Division's quality assurance and improvement program includes reviews of all working papers and audit reports by the CAE. In addition, the Division utilizes staff training and evaluations, an audit manual, and auditee surveys to enhance the quality and effectiveness of its activities. Although not part of a formal review program, these procedures, when combined with the audit staff's experience, ensure compliance with the *Standards*.



**E. 2000—Managing the Internal Audit Activity: The CAE should effectively manage the internal audit activity to ensure it adds value to the organization.**

The Division is generally managed efficiently and effectively. Annual audit plans are generally prepared in accordance with the Standards. However, we identified the following deficiency:

**Condition:** Audit plans do not contain documented approval by Department senior management.

**Criteria:** *Standard 2020* states that the CAE should communicate the internal audit activity's plans and resource requirements to senior management for review and approval.

**Recommendation:** Obtain and document Department senior management approval for all Division audit plans.

**F. 2100—Nature of Work: The internal audit activity should evaluate and contribute to the improvement of risk management, control and governance processes.**

The nature of the Division's work conforms with the *Standards*. The scope of work includes the examination and evaluation of the Department's internal control, compliance reviews, and other special projects requested by Department management.

**G. 2200—Engagement Planning: A formal plan should be developed for each engagement.**

The Division's audit work is generally performed in accordance with the *Standards*. The working papers contain evidence of appropriate planning for each engagement. However, we noted the following instances where planning documentation could be further improved:

**Condition:** The audit program's administrative and planning sections of the latest completed Department internal control review were not signed off and referenced to the working papers. Further, the budgeted hours for this review were not divided by section and an explanation for the significant excess of actual over budgeted hours expended was not included.

**Criteria:** *Standard 2200* states that the internal auditors should develop and record a plan for each engagement. This recording would include the completion and referencing of all administrative and planning sections of the audit program and documentation/comparison of budgeted and actual audit hours for each review.

**Recommendation:** Ensure that all audit program planning procedures are signed off and referenced. Maintain control over budgeted audit hours through section breakdown and explain significant excess actual hours expended.

- H. **2300—Performing the Engagement:** Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement's objectives.

The Division's audit work is generally performed in accordance with the *Standards*. The working papers contain sufficient, competent, and relevant evidence and information to support the conclusions and reports.

- I. **2400—Communicating Results:** Internal auditors should communicate the engagement results promptly.

The Division's audit work is generally performed in accordance with the *Standards*. Audit reports are accurate, objective, constructive, and complete.

- J. **2500—Monitoring Progress:** The CAE should establish and maintain an ongoing monitoring/follow-up system to ensure the timely and effective implementation of management actions.

The Division's audit work generally conforms with the *Standards*. However, we noted a weakness in following up on audit findings resulting from compliance reviews of housing redevelopment agencies:

**Condition:** The Division has not developed and implemented procedures to determine that findings resulting from these compliance reviews have been adequately resolved.

**Criteria:** *Standard 2500.A.1* states that the CAE should establish a follow-up process to ensure that management actions have been effectively implemented.

**Recommendation:** Develop and implement procedures to ensure adequate resolution of all redevelopment agency audit findings.

- K. **2600—Management's Acceptance of Risks:** If the CAE believes that management has accepted a level of risk that is unacceptable to the organization, the CAE should actively engage senior management in discussions in an attempt to resolve the situation.

The Division's audit work is performed in accordance with the *Standards*. The Division Chief discusses significant matters with Executive Management.

- L. **The Code of Ethics:** The Code applies to both individuals and to entities that provide internal audit services. Internal auditors are expected to apply and uphold the Principles of and follow the Rules of Conduct for Integrity, Objectivity, Confidentiality, and Competency.

The Division management and staff reflect, through their work, that they uphold and follow the *Code of Ethics*.

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## C ONCLUSION

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This report discusses the Audit Division's (Division) responsibility to operate under the Institute of Internal Auditors' *Standards for the Professional Practice of Internal Auditing (Standards)*, the objective of our quality assurance review, and an overview of the Division's compliance with the *Standards*. The Division is aware of the requirement to operate in compliance with the *Standards*.

We met with the Division Chief on July 27, 2005, to discuss our observations reported in the *Conditions and Recommendations* section of this report.

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## RESPONSE

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**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT****AUDIT DIVISION**

1800 Third Street, Suite 310  
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September 26, 2005

Samuel E. Hull, Chief  
Office of State Audits and Evaluations  
Department of Finance  
915 L Street  
Sacramento, CA 95814-3706

Dear Mr. Hull:

Thank you for the opportunity to respond to your July 2005 Quality Assurance Review. We are pleased that your audit opinion is that the Department of Housing and Community Development Audit Division generally conforms with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing.

The following is our response to your three conditions noted:

Condition Number One: Audit plans do not contain documented approval by Department senior management.

Recommendation Number One: Obtain and document Department senior management approval for all Division audit plans.

Response: We agree that not all past audit plans contained documented approval by Department senior management, although the plans were, in fact, circulated and approved. All future audit plans will contain documented approval by senior management, including signed approval by all members of the Department's Audit Committee.

Condition Number Two: The audit program's administrative and planning sections of the latest completed Department internal control review were not signed off and referenced to the working papers. Further, the budgeted hours for this review were not divided by section and an explanation for the significant excess of actual over budgeted hours expended was not included.

Recommendation Number Two: Ensure that all audit program planning procedures are signed off and referenced. Maintain control over budgeted audit hours through section breakdown and explain significant excess actual hours expended.

Response: We have corrected this condition. In the current Department internal control review, all audit program planning procedures are being signed off and referenced. Budgeted audit hours are broken down by sections; we will provide explanations for any significant excess actual hours expended.

Condition Number Three: The Division has not developed and implemented procedures to determine that findings resulting from compliance reviews of housing redevelopment agencies have been adequately resolved.

Recommendation Number Three: Develop and implement procedures to ensure adequate resolution of all redevelopment agency audit findings.

Response: In June 2005, Audit Division staff met with the Department's Audit Committee regarding the audits of redevelopment agencies. One of the topics discussed at this meeting was the follow-up of previously reported audit findings. We are currently in the process of developing procedures which will be implemented to determine whether resolution of redevelopment agency audit findings has occurred. Due to resource constraints, the Department will focus its efforts on validating resolution of the most significant findings.

If you have any questions, please call me at (916) 322-3457.

Original signed by Keith Jung

Keith Jung  
Audit Manager